

# Topic No. 414 Rental Income and Expenses

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Cash or the fair market value of property or services you receive for the use of real estate or personal property is taxable to you as rental income. In general, you can deduct expenses of renting property from your rental income.

## Real Estate Rentals

## Personal Property Rentals

## Rental Income

Most individuals operate on a cash basis, which means they count their rental income as income when they actually or constructively receive it, and deduct their expenses when they pay them. Rental income includes:

- **Amounts paid to cancel a lease** – If a tenant pays you to cancel a lease, this money is also rental income and is reported in the year you receive it.

- **Advance rent** – Generally, you include any advance rent paid in income in the year you receive it regardless of the period covered or the method of accounting you use.
- **Expenses paid by a tenant** – If your tenant pays any of your expenses, those payments are rental income. You may also deduct the expenses if they're considered deductible expenses.
- **Security deposits** – Don't include a security deposit in your income if you may be required to return it to the tenant at the end of the lease. If you keep part or all of the security deposit because the tenant breaks the lease by vacating the property early, include the amount you keep in your income in that year. If you keep part or all of the security deposit because the tenant damaged the property and you must make repairs, include the amount you keep in that year if your practice is to deduct the cost of repairs as expenses. To the extent the security deposit reimburses those expenses, don't include the amount in income if your practice isn't to deduct the cost of repairs as expenses. If a security deposit amount is to be used as the tenant's final month's rent, it is advance rent that you include as income when you receive it, rather than when you apply it to the last month's rent.

## Rental Expenses

Examples of expenses that you may deduct from your total rental income include:

- **Depreciation** – Allowances for exhaustion, wear and tear (including obsolescence) of property. You begin to depreciate your rental property when you place it in service. You can recover some or all of your original acquisition cost and the cost of improvements by using Form 4562, Depreciation and Amortization (to report depreciation) beginning in the year your rental property is first placed in service, and beginning in any year you make improvements or add furnishings.
- **Repair Costs** – Expenses to keep your property in good working condition but that don't add to the value of the property.
- **Operating Expenses** – Other expenses necessary for the operation of the rental property, such as the salaries of employees or fees charged by independent contractors (groundkeepers, bookkeepers, accountants, attorneys, etc.) for services provided.

**Note:** In addition to your qualified rental expenses, you may be eligible to deduct an additional 20% of your qualified business income (QBI) if you meet all of the safe harbor requirements; refer to Revenue Procedure 2019-38PDF and Tax Cuts and Jobs Act, Provision 11011 Section 199A - Qualified Business Income Deduction FAQs.

If you're a cash basis taxpayer, you can't deduct uncollected rents as an expense because you haven't included those rents in income. Repair costs, such as materials, are usually deductible. For information about repairs and improvements, and depreciation of most rental property, refer to Publication 527, Residential Rental Property (Including Rental

of Vacation Homes). For additional information on depreciation, refer to Publication 946, How To Depreciate Property.

## **Personal Use**

There are special rules relating to the rental of real property that you also use as your main home or your vacation home. For information on income from these rentals, or from renting at an amount less than the fair market value, refer to Topic No. 415.

## **Limitations**

If you don't use the rental property as a home and you're renting to make a profit, your deductible rental expenses can be more than your gross rental income, subject to certain limits. For information on these limitations, refer to Publication 925, Passive Activity and At-Risk Rules and Topic No. 425.

## **Net Investment Income Tax**

If you have a rental profit, you may be subject to the Net Investment Income Tax (NIIT). For more information, refer to Topic No. 559.

## **Additional Information**

For more information, refer to Publication 527 and Is My Residential Rental Income Taxable and/or Are My Expenses Deductible?